

Herbert Smith

Five years in Japan: Personal Perspectives on the Energy Charter Treaty

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Herbert Smith in association with
Gleiss Lutz and Stibbe

Introduction

- An overview of the ECT
- Two case studies
- Balancing the benefits and burdens of membership
- Concluding thoughts

An overview of the ECT

“Fundamental aim”: “strengthen the rule of law on energy issues”

- Creation of *“a level playing field of rules to be observed by all participating governments, thus minimising the risks associated with energy related investments and trade”*
- Focus on 5 broad areas:-
 - Protection and promotion of Investments in the Energy Sector
 - Free trade in energy materials, products and equipment
 - Freedom of energy transport
 - Reduction of environmental impact by improving energy efficiency
 - Dispute resolution

An overview of the ECT

The guarantees of Part III ...

- Article 10 contains many of the usual IIA protections:-
 - “*fair and equitable treatment*”
 - “*constant protection and security*”
 - Minimum standards of “*Treatment*”, including MFN
 - no “*unreasonable or discriminatory measures*”
 - Umbrella Clause
- Other protections
 - “*Expropriation*” – must fulfil certain conditions **and** subject to compensation (Article 13)
 - Freedom of transfer (Article 14)
 - Subrogation (Article 15)

An overview of the ECT

... are themselves guaranteed by international arbitration

- Part V offers **5 different forms** of dispute resolution:-
 - Courts or administrative tribunals of the Host State
 - Any applicable, previously agreed dispute settlement procedure
 - UNCITRAL arbitration
 - SCC arbitration
 - ICSID Convention/ICSID Additional Facility arbitration

A note on ICSID

A different kind of arbitration

- Established under Washington Convention 1965
- Applies only in relation to “*legal disputes arising directly out of an investment between a Contracting State ... and a national of another Contracting State*” (Article 25)
- Awards automatically enforceable “*as if ... a final judgment of a court in that State*” (Article 54)
- No ICSID award has been dishonoured (cf Burundi)

The benefits for investors:

Case Study 1: Kazakhstan

Amendment of Subsoil and Subsoil Use Law, 2004 (the “BG Law”)

- Early example of “resource nationalism”
- Amendment in 2004 of Subsoil and Subsoil Use Law
- Introduction of new Article 71(3) to coincide with sale by BG of its interest in Kazakhstan
 - *“For the preservation and strengthening of the national economy insofar as it concerns natural resources and energy, in new and existing contracts for the use of minerals, the State shall have a priority right against any other party to the contract or participants in any legal entity possessing the right to use minerals, and other persons on the purchase of the alienated right of such minerals (or part thereof) and/or any part of any such interest (including shareholdings) in a legal person, possessing the right to use minerals use, on conditions no worse than that offered by other buyers.”*
- Conferred grant to the Kazakh State of a right of first refusal over a relevant “alienation”

The benefits for investors: Case Study 1: Kazakhstan

Amendment of Subsoil and Subsoil Use Law, 2004 (the “BG Law”)

- Amendment of Subsoil and Subsoil Use Law simultaneous with
 - Dissolution of JNOC 2005; and
 - Disposal by JNOC of all its E&P assets by 31 March 2005
- Proposed share transfer in one Japanese entity triggered “*alienation*” under Article 71(3)
- Notice received of interest in acquisition of transferred shares

The benefits for investors:

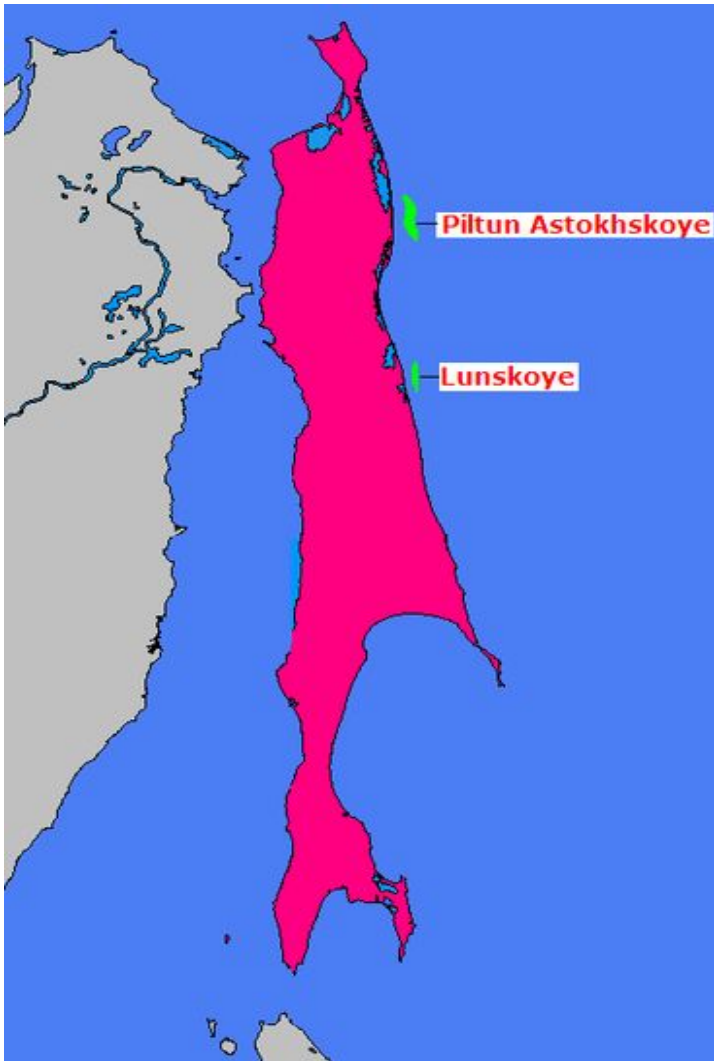
Case Study 1: Kazakhstan

Amendment of Subsoil and Subsoil Use Law, 2004 (the “BG Law”)

- Japanese investors advised Kazakh State of:-
 - Rights under Production Sharing Agreement
 - Corresponding rights under umbrella clause under ECT
 - Other rights under ECT, Article 10
 - Right to ICSID arbitration
- Negotiations between Kazakh State and Japanese investor
- Rights of pre-emption waived
- Transfers completed on time

The benefits for investors:

Case Study 2: Sakhalin 2



- US\$12 billion upstream energy project on island between Russia and Japan
- First ever LNG plant to be built in Russia
- 2 fields: Piltun-Astokhskoye, Lenskoye
- PSA signed in 1994 with Russian Government by SEIC, a JV company comprising
 - Shell: 55%
 - Mitsui: 25%
 - Mitsubishi: 20%

The benefits for investors:

Case Study 2: Sakhalin 2

Increasing calls over recent years within Russia to renegotiate its terms (and those of all other PSAs) – building pressure to give Russia a greater stake

- Cost overruns: \$20 billion
- Environmental issues: claims brought in Russian courts
- “*Moscow expects Shell to present changes to its PSA with the government to allow the State to collect greater profits.*” – Moscow Times, 29 November 2006
- Issue of protecting Japanese energy security

The benefits for investors:

Case Study 2: Sakhalin 2

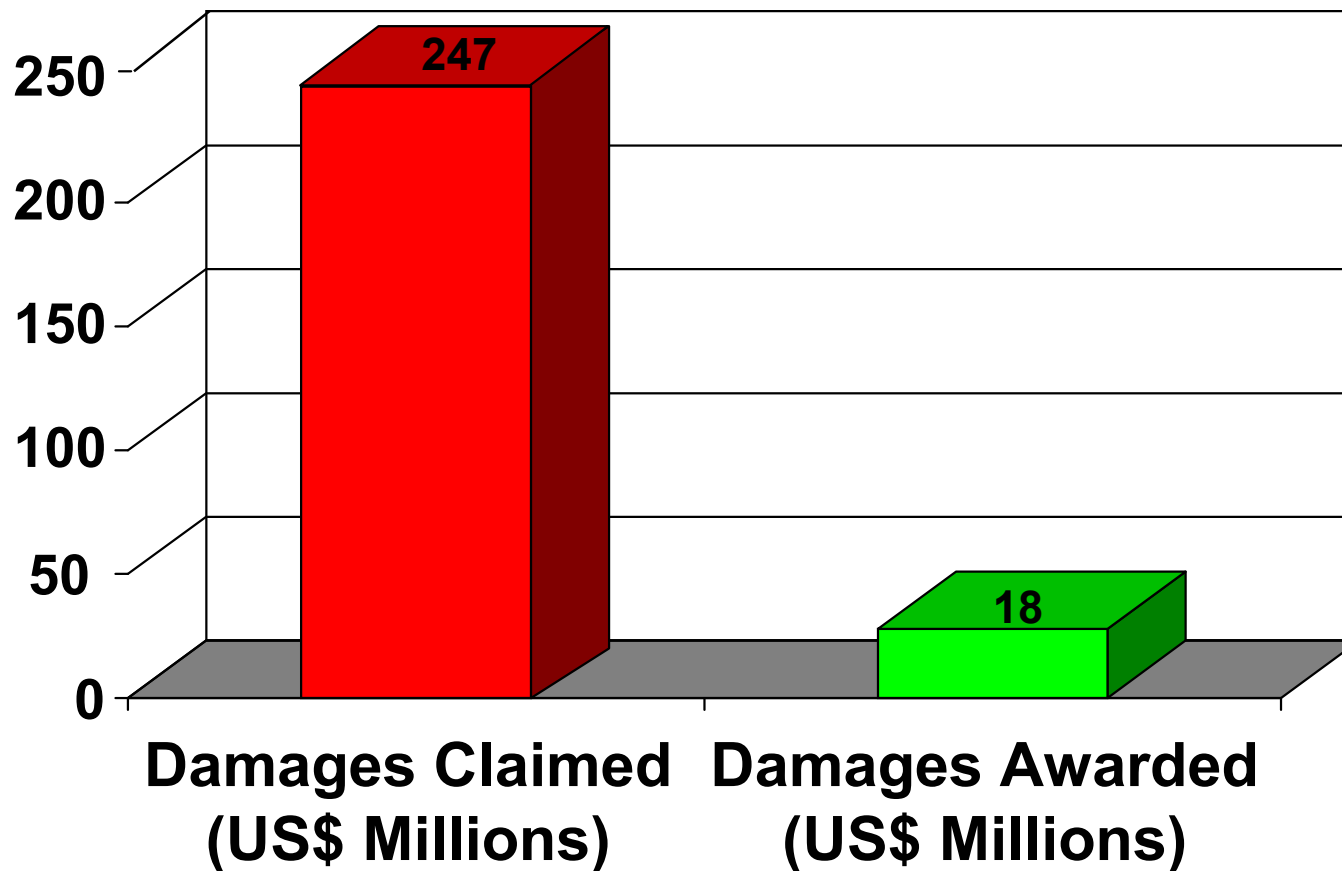
- PSA: reasonably advantageous:
 - Usual contractual protections
 - UNCITRAL arbitration, New York
- Significantly broader protections available under
 - Japan/Russia BIT (not available to Shell/SEIC)
 - ECT (issue of provisional application by Russia)
- Ultimate sanction of State to State dispute resolution under ECT
- Resolution December 2006:
 - Dilution of interest: Gazprom now 50% + 1 share
 - Environmental claims dropped
 - BUT: first LNG cargo due in Tokyo Bay this week

ECT membership: Weighing up the benefits and burdens

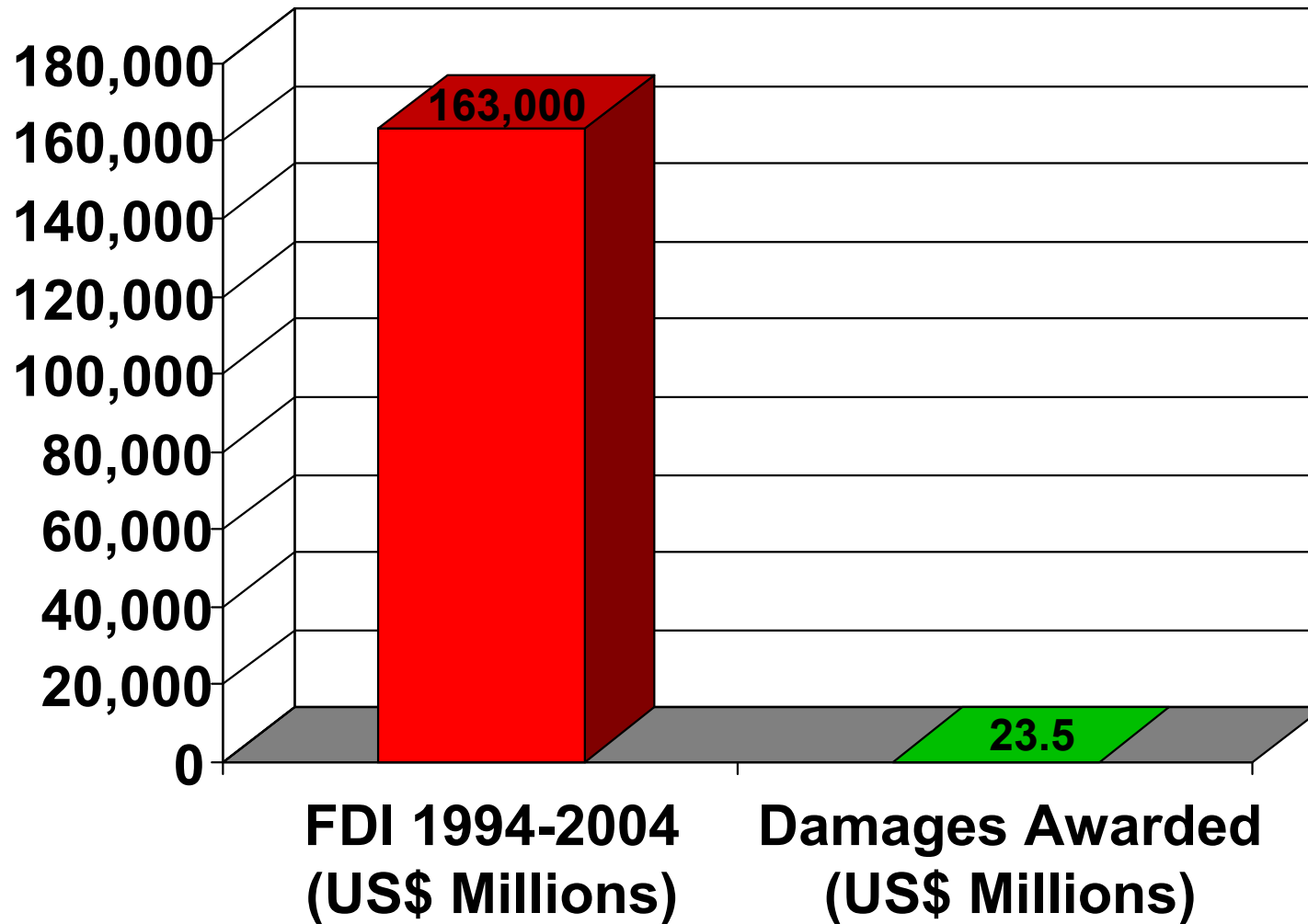
The perceived dangers of investment treaties

- “The costs outweigh the benefits”
- Little evidence that investment treaties deliver sizeable investment
- Investors bring spurious claims because ...
- Arbitral tribunals are too much inclined towards investors and ...
- Resulting arbitral awards are huge, putting enormous strain on national economies

Mexico: consequences of NAFTA membership



Mexico: consequences of NAFTA membership



Comparison with ECT

Secretariat is aware of 20 claims of which ...

14 still pending (10 commenced in the last 3 years)

Of the 10 earlier claims, 4 are still pending and:-

- 2 were dismissed
 - Plama/Bulgaria (claim: \$300 million)
 - Amto/Ukraine (claim: Euros 15 million + substantial interest)
- 2 were settled (details not available)
 - AES/Hungary
 - Alstom/Mongolia
- 2 have public awards – damages claim substantially reduced
 - Nykomb/Latvia: Lats 1.6 million (from c. Lats 7 million)
 - Petrobart/Kyrgyzstan: \$1,130,890 (from c. \$4 million)

General trends

- No real explosion of ECT claims
 - Of 10 “new” claims:
 - 4 are against Turkey; and
 - 2 against Hungary
- No real evidence of excessive awards
 - Large claims are brought – but are not being granted
- The fact that claims are brought suggests that the ECT is working
 - Investments are being made
 - Investors are being protected – if only by a fair hearing

Personal perspectives

Lack of awareness of the ECT and investment treaties in Japan

- Leading companies are not familiar with the ECT and what the ECT can do for them
- So investments are not necessarily being promoted by Japan's membership of the ECT
- BUT Japanese investments are being protected by the ECT
 - Kazakhstan, Sakhalin (although not yet used in anger)
 - Third potential claim
- One major issue is education of investors and their advisers
 - “*What is ICSID?*”
- The future
 - HS standard advice to leading trading houses/E&P companies
 - “*A BIT is free*”

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“Excellent” Who’s Who Legal, 2007/8

“Clients are impressed with Dominic Roughton’s “extensive knowledge of international law” and his “precise and effective interpretation and presentation.”
Chambers Global 2008, PIL

A “highly effective emerging player in PIL.”
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2005/6, 2006/7**

LCIA representative in Japan since 2003

**Leading Individual – Dispute Resolution:
foreign firms in Japan”. Asia Pacific Legal
500, 2005/6, 2006/7 and 2007/8**